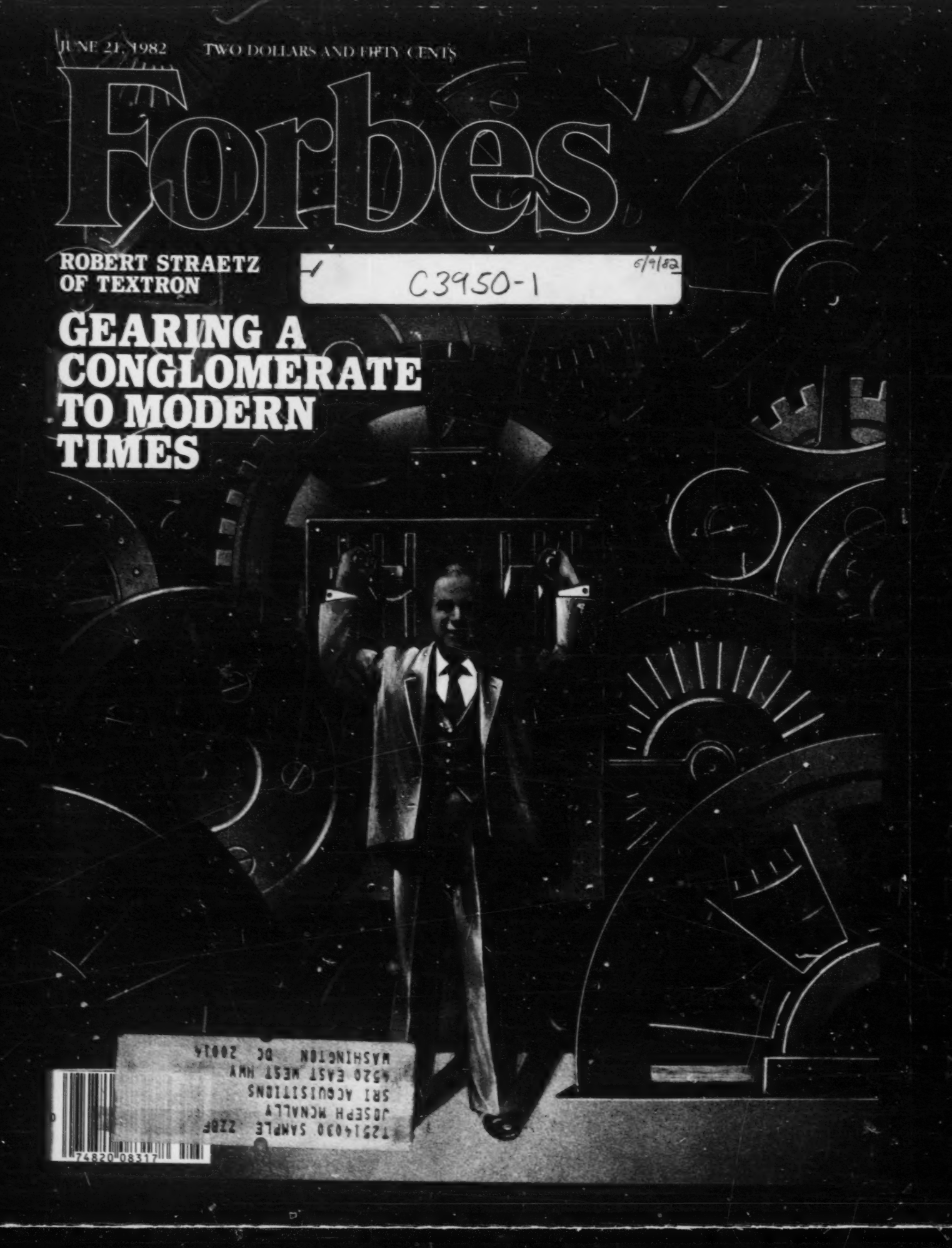
JUNE 21, 1982 TWO DOLLARS AND FIFTY CENTS

Forbes

ROBERT STRAETZ OF TEXTRON

C3950-1 6/9/82

GEARING A CONGLOMERATE TO MODERN TIMES



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Volume 129,
Number 13

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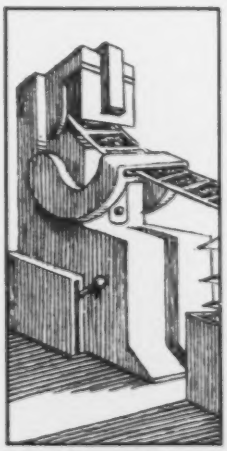

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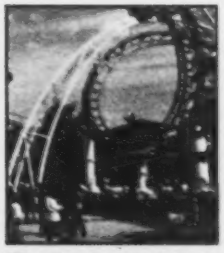

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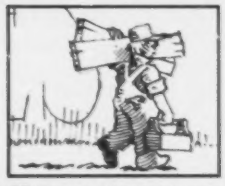

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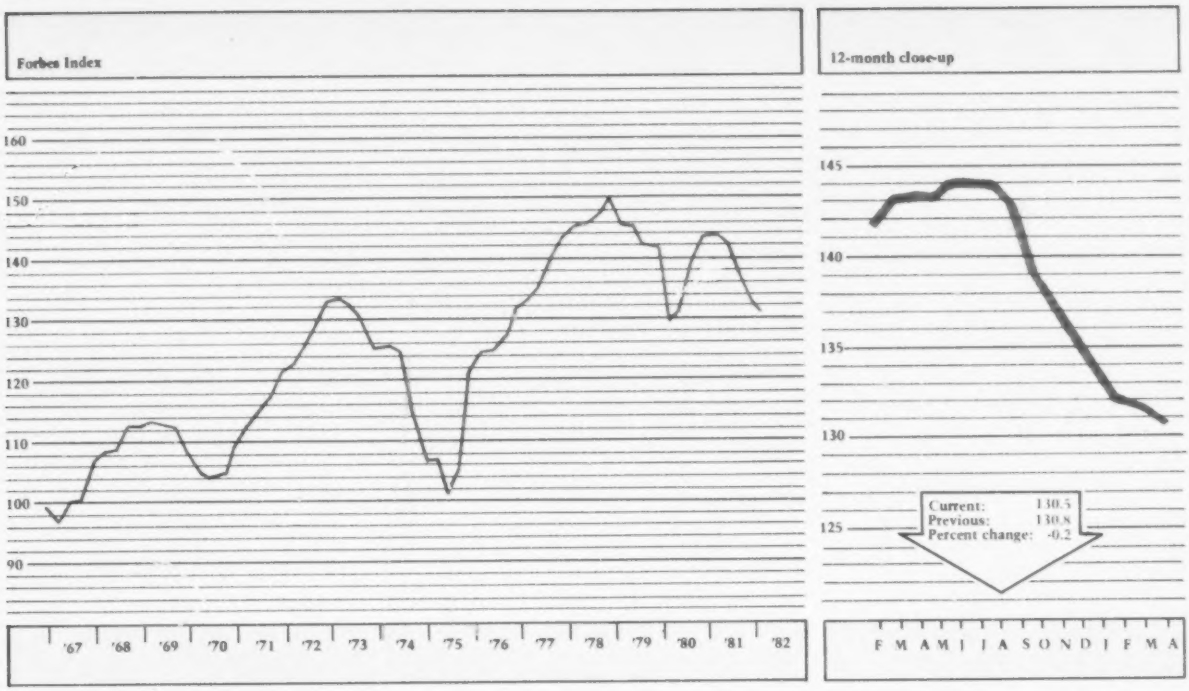
The Forbes Index



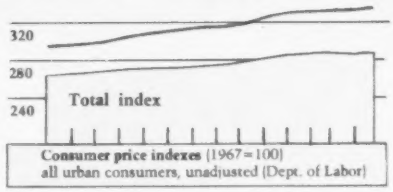
Steady as she goes. The Forbes Index is holding steady, indicating that the recovery is still a long way off. The good news is that the recession is grinding away at inflation. The Consumer Price Index rose a mere 0.4% in April, following an actual decline in March. The April figure translates into a relatively low annual inflation rate of 4.8%.

On the positive side, new housing starts increased again, rising some 6.9%. But that news is less upbeat than it seems. Current starts are some 31.5% below the year-earlier levels. Personal income, meanwhile, fell 0.2% in April. That's further proof that consumers will not be able to lead the way to recovery until after July 1. Then workers will receive a 10% tax cut and Social Security recipients will see benefits rise 10%.

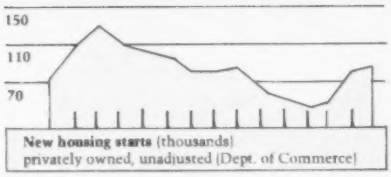
The Forbes Index Components

The FORBES Index is a measure of U.S. economic activity composed of eight equally weighted elements: **Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, the change in the amount of consumer installment debt outstanding.**

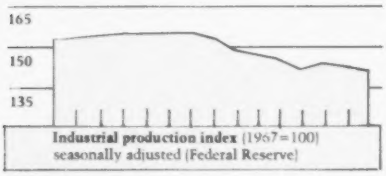
To measure these eight elements, FORBES monitors 11 series of U.S. government data. The last 14 months' data for each series is presented at right.



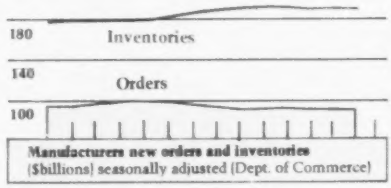
Consumer price indexes (1967=100)
all urban consumers, unadjusted (Dept. of Labor)



New housing starts (thousands)
privately owned, unadjusted (Dept. of Commerce)



Industrial production index (1967=100)
seasonally adjusted (Federal Reserve)



Manufacturers new orders and inventories
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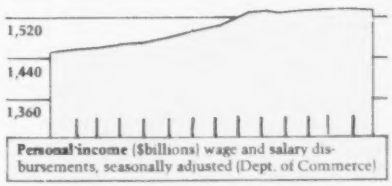
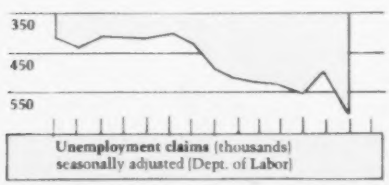
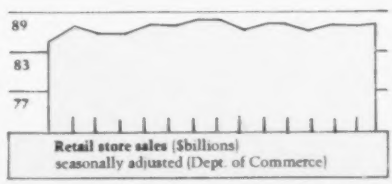


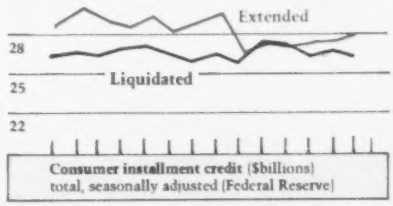
Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)



Unemployment claims (thousands)
seasonally adjusted (Dept. of Labor)



Retail store sales ($billions)
seasonally adjusted (Dept. of Commerce)



Consumer installment credit ($billions)
total, seasonally adjusted (Federal Reserve)

Forbes

Housing starts may be badly flattened by recession, but everyone still wants to jump into the swimming pool.

The American way of recession

By Jeff Blyskal

THERE IS TURMOIL in the Falklands, corporate earnings are collapsing and over 9% of the work force is unemployed. Amid the storm, however, there are safe havens. One of them is the swimming pool business, where the desire for suntanned, water-slicked skins is keeping the $3.5 billion-a-year industry splashingly strong.

Over the past three years housing starts took a half gainer off the high dive, but pool installations rose 9%. Only last year did pool "starts" drop slightly—off 2%, to some 208,000, and so far 1982 demand seems to be holding firm. That strength is unusual because pool starts are normally more closely tied to the direction of new housing activity.

"We're enjoying another record year," says Arnold Greenberg, chief executive of $178 million Coleco Industries, the nation's largest above-ground pool manufacturer. Hartford-based Coleco, which makes everything from $25 Dukes of Hazzard wading pools to $3,000, 41-footers with enough decking for an aircraft carrier, expects 1982 pool sales to reach $75 million, a 15% gain. California-based Doughboy Recreational, meanwhile, is going ahead with a $4.5 million expansion, despite a slight sales decline. And manufacturers of pool-related products, like $2 billion Olin Corp., which makes HTH and Pace pool chemicals, are probably doing best of all: With 4.3 million U.S. swimming pools, there's a lot of algae and water acidity to control, and it costs about $150 a season to maintain a typical pool.

Not everyone, of course, is entirely isolated from broader economic conditions. Demand for in-ground installations is off by at least 5%. Bad, but compare this decline with the 13% backflip in built-in pool construction that accompanied the 1974 recession. When times are bad, the less expensive merchandise sells.

Built-in pools cost at least $7,000, while most families can get in the swim with a respectable-size above-ground Shangri-la for $800—less than the cost of a personal computer.

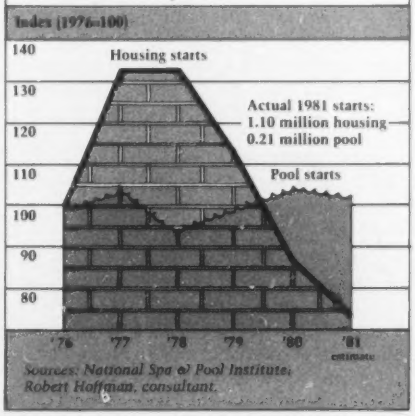
Why are pool sales so buoyant in this recession? For one thing, gasoline prices have made vacations more expensive. "The family that can't afford to go to Cape Cod," says Greenberg, "can afford a pool that provides a lot of recreation for years." Fewer house sales also are an incentive for homeowners to fix up what they are stuck with by adding a pool. Then, too, some folks still have money. "Those who can afford the expensive pools are still buying them," explains Julian Price, who is running 15% ahead of last year in building top-of-the-line in-ground installations in North and South Carolina communities.

If anything has—or will—hurt the pool business this year, it is the cold, wet spring weather. "We were going great guns last week until the weather went cool again," says Bob Ellentuck, president of the seven-store Harrow's pool center chain in New York. "We haven't seen a summer day yet, but when that happens, business will be sensational."

Is a strong pool business amid economic confusion simply recession American style? Some people think so. At $54 million Heldor Industries, for example, sales have more than quadrupled since 1977 and return on equity is nearly 23%. The New Jersey-based company makes built-in pools with vinyl liners, which cost significantly less than concrete installations. "Swimming is like sex and drinking and gambling," says H.J. (Duke) Ellington, Heldor's chairman. "When people are unemployed they're going to do more of it." ■

Splash!

Swimming pool construction usually parallels housing starts—but not in recent years.



Sources: National Spa & Pool Institute; Robert Hoffman, consultant.

Wall Street throws out babes with bathwater. How else explain the beating these great oil service stocks have taken?

Class will tell

By William Baldwin and Toni Mack

WALL STREET HAS BEEN as unbalanced in the oil glut as it was in the oil boom. The stocks of oil service companies have lost half to two-thirds of their value in little more than a year. Such is the passion of crowds. Where the price of oil that fuels the business was once extrapolated to the sky, now it is extrapolated straight to hell.

Forgotten in the rout is that the oil service industry, like any other, has its better operators who manage well through fat years and lean.

Giants like Schlumberger and Halliburton are in this category. So are some smaller outfits with strong market positions. Parker Drilling Co. can drill as far off the beaten track as an oil company wants it to go. Cameron Iron Works' name is synonymous with a basic variety of blowout preventer. Smith International makes more below-the-surface tools than anyone. Rowan Cos. is to offshore drilling what Parker is to land drilling.

All four of these small to medium-size companies are a half-century old or more—no newcomers lured by latter-day oilfield profits. Most, in fact, were pioneering technology for the adolescent industry when H.L. Hunt was trading oil leases in east Texas.

Men like Bobby Parker of Parker Drilling don't get dizzy in the good times; they survived excruciating years like 1958, when rigs went for 10 cents on the dollar. His son Robert Parker Jr., president of the company, puts it this way: "You just can't get scared and run away."

"I'm working for the elite"

In the last decade Tulsa's Parker Drilling has risen smoothly from $3.3 million in earnings to $79 million on $582 million revenues in fiscal 1981. Parker's earnings this year seem sure to rise again; through the first half earnings were up 24%. Today, when a third of U.S. rigs are out of work, 90% of Parker's 138 rigs are running.

Why? Management. Last year, when fledgling contractors leased rigs on short contracts—in the belief that rates would go higher—Parker let only 20% of his fleet go short term. In August he began signing one-year contracts, and around New Year's the rig count started to fall.

It's a family affair, still 21% owned by Parkers. Robert Parker, chairman, bought his father's 22 rigs in 1954, and now his 33-year-old son runs day-to-day operations as president. Back in 1954, though, Parker's father, glum about drilling's future, wanted to get the family out of the business. "He was right for about 15 years," says Parker, a slight, lively man of 58. "I was just young enough to where I didn't know I couldn't do it."

He survived by drilling where no one else wanted to. In 1959 Parker decided to go deep—two to six miles down. The market was less crowded and still is. Likewise, he looked abroad in 1965. Now his lightweight helicopter-lifted and TBA (Transportable By Anything) rigs bore holes from the Arctic to the Sudan, and some 40% of revenues come from overseas.

Parker's magic is in his people. Even though Parker's fleet grew 30% over the last two years, the company has kept most of its well-paid men in a trade in which roughnecks are as fickle as pretty girls at a dance. Parker's accident rate, a measure of inexperience, runs about 20% below the industry average.

There's a lot of talk about "the spiritual realm" at Parker headquarters, and the Methodist Parkers send a company preacher to visit the rigs. Drinking, even off the rig, is nominally (and unenforceably) forbidden; drug users are outlawed.

Naiveté? Buster Trout, a thick-muscled 30-year veteran who runs a Parker rig half an hour outside Chickasha, Okla., doesn't see it that way. During the boom others tempted him with $300 to $500 a day. Ask him why he didn't go, and he's flummoxed for a minute. "Parker Drilling," he finally offers. "They're honest people." His brother, a son and a nephew are also Parker hands. Says his son, "I'm working for the elite."

It's a family business, but it's no club. In the mid-1970s, seeing a few strong years ahead, Bobby Parker retired "the people of my era" and hired men now in their 30s. "If you didn't do that, you'd be a little bit too smug, and say, 'We'll just sweat this one out till the good work comes back,'" he explains. "These young men hustle like mad to show me they can run these rigs in the worst of times." He laughs and slaps his desk. "I love it!" Trust an old hand to see the hazard in experience.

The blacksmith shop

"Hostile environment" is a term that crops up often in the conversation of M.A. (Mike) Wright, 71, chairman of Cameron Iron Works, and his 38-year-old president, Philip Burguieres. Their business is certainly hostile these days: The $929 million (fiscal 1981 sales) Cameron is watching a $1 billion backlog in oil tools evaporate, and recently imposed a hiring freeze. The executives, though, are talking about the harsh drilling conditions their products are designed for. By focusing on this nasty end of the energy market, Cameron has so far maintained operating margins of 25% on its drilling and production wares and a compound earnings-per-share growth rate of 30% over the past decade.

Houston-based Cameron got its start 60 years ago with the invention of the ram blowout preventer, a device that chokes off the space around a drilling pipe when an oil rig hits a dangerous pocket of pressure. Competitors—chiefly privately held Hydril Co. and NL Industries' Shaffer division—have horned in on the market but taken only half of it away. Cameron has steeled itself for the fight by investing in technology. It employs, for example, 32 metallurgists.

In a business that enables drillers of the deepest wells to deal with pressure surges of 20,000 pounds per square inch, metallurgy is key. Cameron can brag about a forging press that, with its

35,000 tons of force, is the third largest in the U.S. and it's a nice toy competitors don't have. Out of it come 2,000-degree-hot billets that will be shaped into oil tools. It's just a modern version of a blacksmith hammering red hot metal to eliminate bad spots.

"We melt our own metal and forge our own oil tools," says Wright. The competition, says Burguieres contemptuously, has to make do with castings. Competitors, of course, are prepared to argue that the best casting is as good as any forging, but the perceived superiority of the latter is enough to give Cameron a slight edge in pricing its products.

And these gadgets do not come cheap. Cameron's smallest blowout preventer lists for $38,965, and a typical drilling rig has several stacked one on top of the other. Cameron also

Robert Parker of Parker Drilling
Rigs from the Arctic to the Sudan.

makes "Christmas trees"—the tangle of valves that control flow from a producing well—and other wellhead equipment. It offers an offshore Christmas tree that is buried beneath the ocean floor, so it can't be toppled by an iceberg or fishnet. Cost, about $1.5 million. Burguieres shrugs. "You could lose that in a couple of hours" of a catastrophic spill, he says.

The immediate future for Cameron portends, if not a decline in earnings, at least a slowing of its heady growth. Non-oil-tool lines—a third of the company's business—are also faring poorly these days: seamless pipe for power plants and forged parts for jet engines. But the longer trends, the world's going deeper and offshore—to

It's crystal-clear.
It's a bit more expensive, but for a crisp Gin & Tonic,
the world comes to Gordon's.®

Tarred with the same oil

Such was the stock market's emotional overreaction to prospects of an oil glut—a glut that seems to be vanishing even now—that some excellent oil service companies are selling at distress prices.

Company	Recent price	—Price range— 1980 to present	Latest 12-month earnings per share	Latest 12-month P/E ratio	Latest 12-month earnings yield	Latest fiscal year sales (millions)	Latest fiscal year return on equity
Baker International	28⅝	53½–25¾	$4.10	7.0	14.3%	$2,140	26.7%
Cameron Iron Works	29	67 –24⅛	5.20	5.6	17.9	929	23.7
Dresser Industries	19⅜	57 –19¼	4.23	4.6	21.8	4,615	17.7
Gearhart Industries	16	60¾–15⅝	2.05	7.8	12.8	345	19.8
GEO International	15⅞	46½–15½*	4.24	3.7	26.7	436	37.2
Halliburton	32¼	86⅜–32	5.72	5.6	17.7	8,508	23.2
Helmerich & Payne	18⅞	54⅛–18⅞	3.26	5.8	17.3	288	27.7
Hughes Tool	24¾	48⅝–23½	4.84	5.1	19.6	1,759	24.6
NL Industries	22¾	48⅝–15¾	5.22	4.4	23.0	2,464	33.6
Ocean Drilling & Exp	19⅞	54⅞–17¼	3.45	5.8	17.4	924	27.8
Parker Drilling	13½	36¾–12⅜	3.05	4.4	22.6	582	28.4
Reading & Bates	15⅝	39⅞–11¾	3.14	5.0	20.1	537	22.9
Rowan Cos	10¾	23½– 9⅛	2.74	3.9	25.5	369	27.5
Schlumberger	44⅞	87⅛–40	4.64	9.7	10.3	5,783	33.8
Sedco	32¼	49 –17⅜	3.34	9.7	10.4	385	15.1
Smith Intl	30¾	70¼–28¼	6.29	4.9	20.5	1,194	24.0
Tidewater	22⅛	54⅜–19⅛	3.96	5.6	17.9	354	21.1
Western Co of North Am	11	32⅛– 9	2.30	4.8	20.9	726	29.2

*Price range for less than entire period.

Sources: Wilshire Associates; Standard & Poor's; Forbes

hostile environments—to find energy, run in Cameron's favor. Says Burguieres: "Wells with pressures over 3,000 pounds or corrosive environments where normal steel would disintegrate, or offshore—that's about 25% of the 94,000 wells drilled last year. But it represents more dollar value than all the rest of the wells."

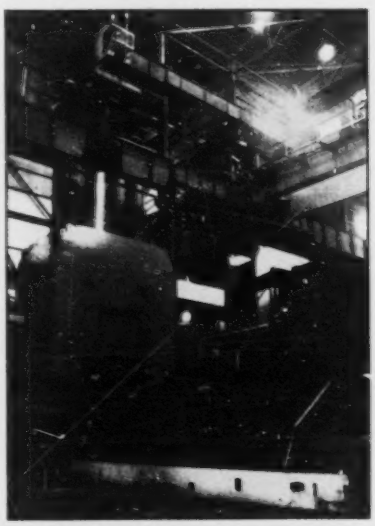
The invader

Jerry Neely, chairman of $1.2 billion (revenues) Smith International, is a pugnacious man. Four years ago he could not find a good-size well stimulation company (one that fractures rock around a well so hydrocarbons flow more easily) to buy at a less than rapacious price. So he simply started from scratch.

It was a gutsy move. Big Halliburton is the granddaddy of the business, and Neely's other competitors range up to ten times Smith's size in revenues. Stimulation, too, is "highly complex, hard to get into," says one competitor grudgingly. "But Smith has made some real inroads."

Neely knows something about chipping away market share—much to Hughes Tool's chagrin. In 1971 Hughes had over twice as much of the drill bit market as Smith. Last year Hughes' worldwide share had slipped to 36%, while Smith's climbed to 31%, by a Paine Webber estimate. What happened? Neely saw that Hughes depended more on technical than marketing prowess. He pushed salesmen into the field, aimed especially at deep and difficult wells that eat bits faster. Now he's pushing the salesmen abroad.

Neely, now 45, married the founder's daughter, but it didn't make him lazy. A University of Southern California graduate in industrial management, he took ten years to work from plant manager to chief executive in 1976. "He's done a superb job," says John Wellemeyer, oil tools analyst at Morgan Stanley. Since 1976 earnings have nearly quadrupled to last year's $133 million, for an 11% net margin.



Cameron's 35,000-ton press at work
A nice toy competitors don't have.

Not all is rosy, of course: Neely may face damages from a patent suit Hughes just won, and his stimulation company probably won't break even, as he expected this year.

Why has he gone after such tough markets? Because Smith's mainstays used to be oilfield commodities, like drill pipe and shock absorbers (called "subs"), that almost anyone with a dream and a bank loan can make. As orders grew during the latest boom, Neely subcontracted some of the work. As orders wane, the subcontractors go. Commodities have dropped from 43% to 31% of revenues in the last five years.

Instead, Neely is busy—too busy for an interview—creeping up on markets not so tied to drilling budgets. He has spent around $65 million so far on stimulation, easing the company into the Rocky Mountains. Two years ago he paid $83 million for McEvoy Cos., which makes devices that control a well's flow. There Smith competes with the likes of Cameron Iron Works.

Analysts are keen on Smith's chances. They predict earnings growth about twice that of its customers. And with long-term debt just 20% of capitalization, Neely—who owns $12 million of Smith's common—can probably mount whatever slow invasions he wants.

It's a big ocean

"One of the majors that has 14 rigs working in the Gulf of Mexico told us they were going to cut back to 4," says Charles Yeargain, the gruff 56-year-old head of Rowan Cos.' drilling division. "Maybe they're overreacting."

Maybe they are. In Yeargain's 35 years at Rowan, the Houston-based contract driller and operator of offshore oil service helicopters, he has seen many an overreaction. Currently he's witnessing what appears to be a classic overreaction on Wall Street, which has run Rowan stock down to half its former high and about 4.5 times likely 1982 earnings.

Sure, the official rig count is off 32% from its December peak. But Yeargain isn't very worried. Here's why: Most of the 1,450 idle rigs are shallow land units, a market Rowan has shunned in favor of deep and offshore work. And that famous rig count measures only U.S. activity. Rowan does more than half its drilling abroad. Last month it towed a rig from the Gulf of Mexico to Trinidad; another rig is headed for the North Sea. The company already is drilling off the shores of Venezuela, Brazil and Indonesia, far from the wave of tax-shelter competition that is making life miserable in the Gulf.

Within the U.S., Rowan's heaviest concentration is on Alaska's North Slope, where the severe environment thins out the competition. "We've got five [deep land] rigs there that are all working and will be working for the rest of the year," says Yeargain.

Rowan's rigs, accounting for all but a tenth of revenues, enjoyed an incredible 49% operating margin last year. Net income was $112 million, on $369 million revenues. Earnings per share have climbed at a 42% annual rate over the past decade.

It's a risky business. A new jack-up rig—one that sits on legs extendable to the ocean floor—costs $40 million. In good times the operator can rent it with crew for $30,000 to $65,000 a day. But an idle rig is like an empty airplane seat: The huge fixed costs impel the owner to take any price he can get. Domestic rental rates for jack-ups could fall 30% over the year, says James Crandell, a Salomon Brothers analyst. Five of Rowan's 34 rigs are now idle. If not for its geographic dispersion and outlandish profit margins, Rowan would be suffering.

With its well-ballasted balance sheet—$437 million equity, $84 million debt—and a long list of Third World coastal nations just catching up to $20 oil, Rowan, it seems, isn't about to sink in the glut. ■

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There's always a hot product in the brokerage business. Now it's stock index futures—a market that is booming beyond its promoters' wildest dreams.

Tired of steak? Buy the sizzle

By Thomas O'Donnell and Ben Weberman

You'll be reading a good many how-tos about playing stock index futures. Invest a few minutes in this cautionary report, which explains that index trading is a zero-sum game in which the only people certain to make money are brokers and trading floor professionals.

WHEN STOCK INDEX FUTURES were introduced three months ago, optimists hoped that by year-end the number of contracts traded would reach 5,000 per day. Instead, that target has already been passed. Today, daily volume on the three exchanges that trade stock futures totals 16,300 contracts. "This could be the most successful financial instrument ever," says Harold Bradley, marketing director for the Kansas City Board of Trade, the first exchange to trade the contracts.

A major reason for this stunning success is that everybody has an opinion on the market, and now there's a well-organized way to put cash behind those opinions. Speculators and hedgers doing so are now generating perhaps $2 million per week in commission income. Should you contribute? Perhaps—but only if you like to take chances and you know what you're doing. Investors who correctly predict the stock market's general direction but buy the wrong index or trade on the wrong exchange can lose big money fast.

Here's why. The Kansas City Board of Trade futures contract is based on the Value Line Composite Average. The New York Futures Exchange, meanwhile, offers the New York Stock Exchange Composite Index. And the Chicago Mercantile Exchange uses the S&P's 500 Stock Index. The last two are weighted indexes, while Value Line is not—and the difference is crucial. The unweighted Value Line index of 1,700 stocks is more volatile than the actual market. Small companies can move the average just as much as blue chips.

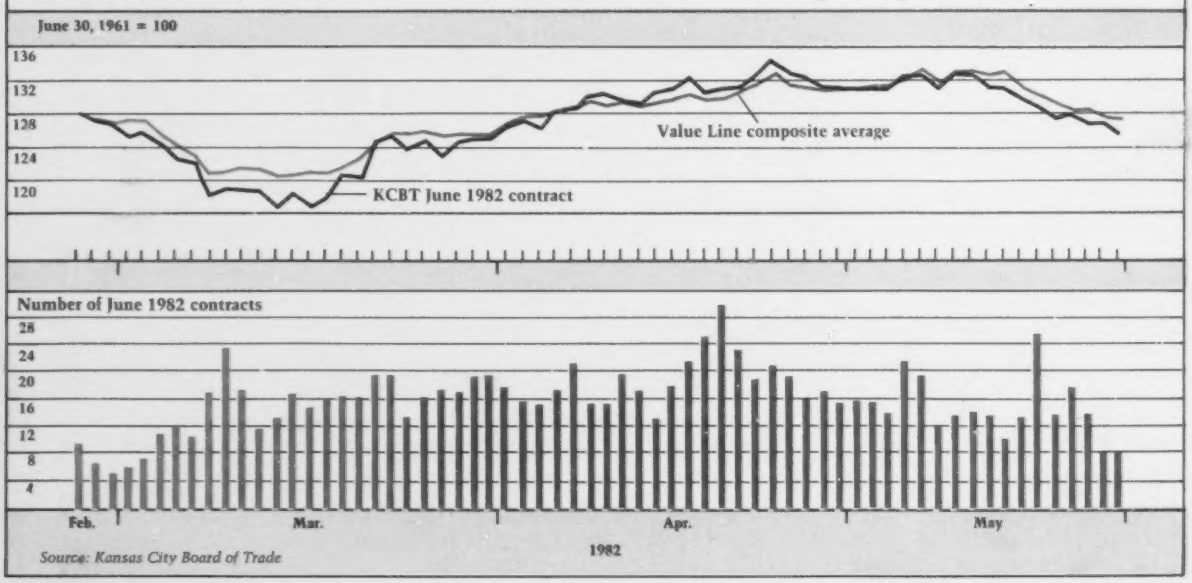
Since newly created futures markets are dominated by speculators, you would think fast-paced Value Line contracts would generate the greatest volume. Think again. Trading on the Kansas City Board has stalled because the Chicago and New York exchanges are putting heavy muscle behind their products.

The key to survival for any futures exchange is liquidity, so that strategy is paying off at both big city exchanges. Volume in New York averages 6,800 contracts per day and in Chicago 7,500 contracts, compared with just 2,000 in Kansas City.

Another reason Chicago and New York have pulled ahead is that the NYSE and S&P's indexes they use are more representative of institutional portfolios. In 1972 and 1976, for ex-

Before the fall

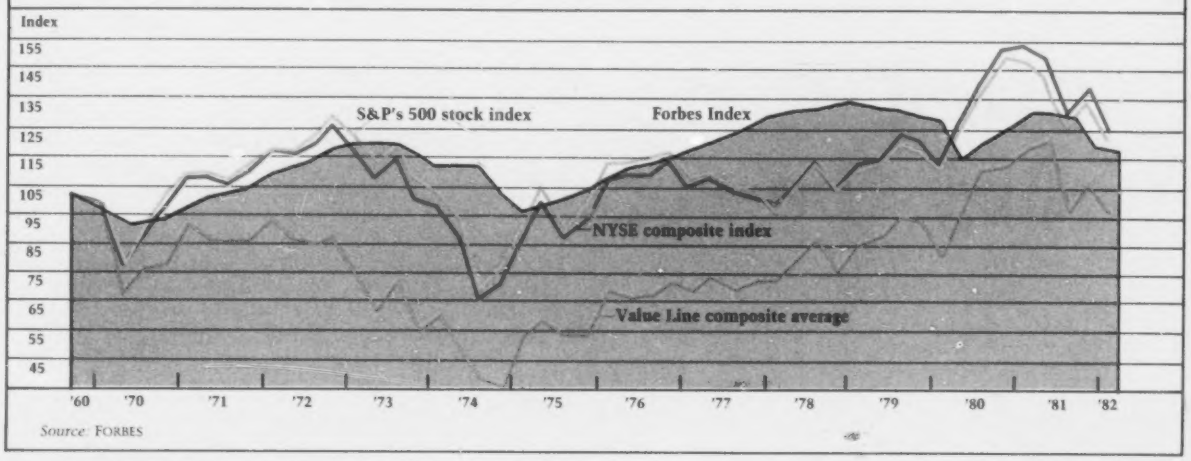
Trading volume for June 1982 Value Line futures has stalled. Meanwhile, the contract has moved below its underlying index. That means speculators—though fewer than before—expect a dip in the stock market.



Source: Kansas City Board of Trade

Which future is now?

As this comparison with the Forbes Index shows, the stock market can be a leading indicator of economic trends. Stock averages—especially the S&P's 500 and the NYSE Composite—reflect investor psychology. The unweighted Value Line index is more volatile. It gives equal play to large and small companies. During a boom investors like the little guys, but when times are tough, they put a higher price tag on blue chips.



Source: FORBES

ample, the Value Line index inched down and the market went up.

No matter which index is involved, the simplest way to use stock futures is to buy them instead of equities. Take the Kansas City contract, which is based on the Value Line average multiplied by $500. Not long ago the index registered 125, making one contract worth $62,500—if it trades without premium or discount. You can buy that for about 10% down, or $6,500. If the contract rises by 13 points, you double your money.

With stocks, margins are 50%—or $30,000 when purchasing shares worth $60,000. Commissions are figured differently, too. It costs about $500 to move in and out of stocks worth $60,000, while $60 to $85 buys a retail round-trip ticket in stock futures. The analysis is simple, too: Just pick the market's direction and buy or sell accordingly.

Some professionals are also using futures as a way to short sell—particularly in a declining market when there is no stock price uptick to get off a short sale of that stock. Suppose, for example, a money manager guessed correctly that the market was peaking on May 7. If he sold S&P's contracts due June 1982, which then stood at 120, he could have pocketed $4,000 on each three weeks later. Why? Because the S&P's average had fallen to 112. The alternative would have been to sell stocks directly, which could have created substantial commission costs and a big tax bite.

The pros are willing to be so innovative for one big reason: In the 1970s the explosive growth of fixed income financial futures acquainted them with commodities. Unfortunately, however, many lost money. They are hopeful that won't happen this time around because stock futures have a big advantage over fixed income futures: They are far less volatile. With fixed-income instruments such as T bills, certificates of deposit, mortgage-backed paper and foreign currencies, speculators can get wiped out by "blips" even if their view of the market is correct. Not so, for example, with the NYSE index. Since it was created in 1965, daily movement has averaged half a point. The largest single-day gains and losses have been just over 2 points, or about $1,000 a futures contract. Even over a month, the NYSE index has never gained more than 5.91 points ($2,955) or lost more than 7.30 points ($3,650).

That stability makes stock futures a good way to hedge. Even unwilling money managers may someday be forced to play the game. "If an institution doesn't hedge and loses big money as a result, it may get sued," says Barry Frost-White, an assistant vice president of ContiCommodity Services, "which could help lead to a rethinking of the prudent man rule." That would make the market more respectable.

Though that stability may attract institutional hedgers, stock futures may actually be too tame for some speculators. There are other disadvantages, too, compared with more rough-and-tumble commodities trading. Recent legislation taxes commodities futures income at the attractive rate of 32%, but investors in stock index futures may not realize that such light tax treatment does not apply to them. Because settlement is for *cash*, stock futures are taxed like securities. Short-term profits are subject to a maximum 50% levy.

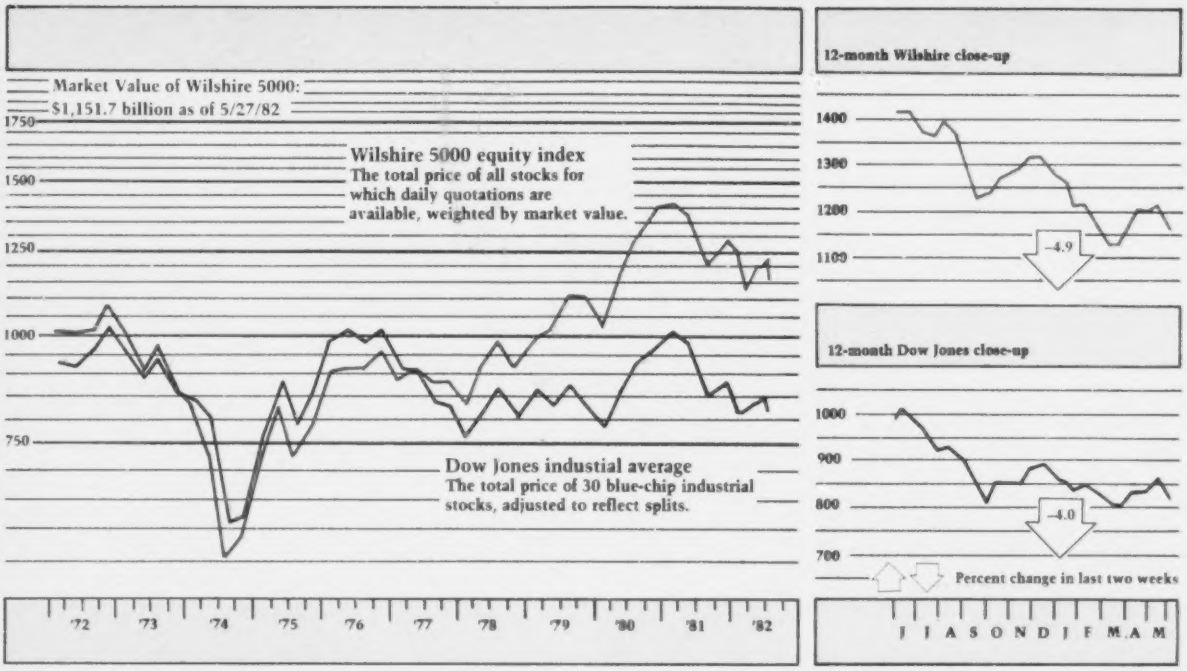
There's another drawback as well. The 10% margin requirement on stock futures is attractive when compared with the 50% requirement for buying equities directly. But it's bigger than the 5% or less applied to other commodities. The comparatively high 10% figure was set by exchanges because they feared the Federal Reserve, which has the power to set margins, might disapprove of lower limits.

That hasn't happened so far—but if the market grows as rapidly as the brokers would like, there is the possibility of government action. "There are only about 200,000 people who have traded commodities, but there are about 32 million people who own stocks," says Marty Presler, a Smith Barney first vice president. "Imagine the volume if even 10% of them get into this."

Imagine indeed. Playing the futures really is more like a trip to the racetrack than conventional investing. Sure, the ability to hedge positions may be helpful to portfolio managers, but stock index trading does little to help build capital within the economy. That's the essential, almost magical, function of equity markets.

As long as the hoopla in Kansas City doesn't get in the way, fine. But if it does, expect a crackdown. No one likes the idea of the tail wagging the dog. ■

The Forbes/Wilshire 5000 Review



Down the drain: $61 billion. Investors took a beating over the last several weeks—after the market had been making slow but steady progress through most of the spring. From late March to mid-May the Wilshire index gained over $77 billion. But over the last two weeks the Wilshire slipped 4.9%, and more than $61 billion in market capitalization was lost. These declines are distributed fairly evenly among the three exchanges. The NYSE is down 4.9%, the Amex fared slightly better, with a 4.8% setback, and the NASDAQ slightly worse, with a 5% reverse. The four-week picture is similar: The Wilshire index is off 3%, and NASDAQ and NYSE stocks are behind 3.1%. However, Amex stocks showed a little more resilience and lost only 1.9%.

The decline in market focus groups, however, was anything but evenhanded. There was a much stronger exit from more speculative issues. High-volatility stocks fell 3.7%, while low-volatility issues lost only 0.9%. For some strange reason, issues priced over $40 recorded the biggest setback—a 4.1% decline over the four-week period.

Close-up On The Equity Markets

Performance of five leading indexes

Percent change	Wilshire 5000	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	–3.0	–2.4	–3.1	–1.9	–3.1
in last 52 weeks	–18.2	–16.9	–16.4	–30.0	–19.7

Stock performance based on five key investor yardsticks

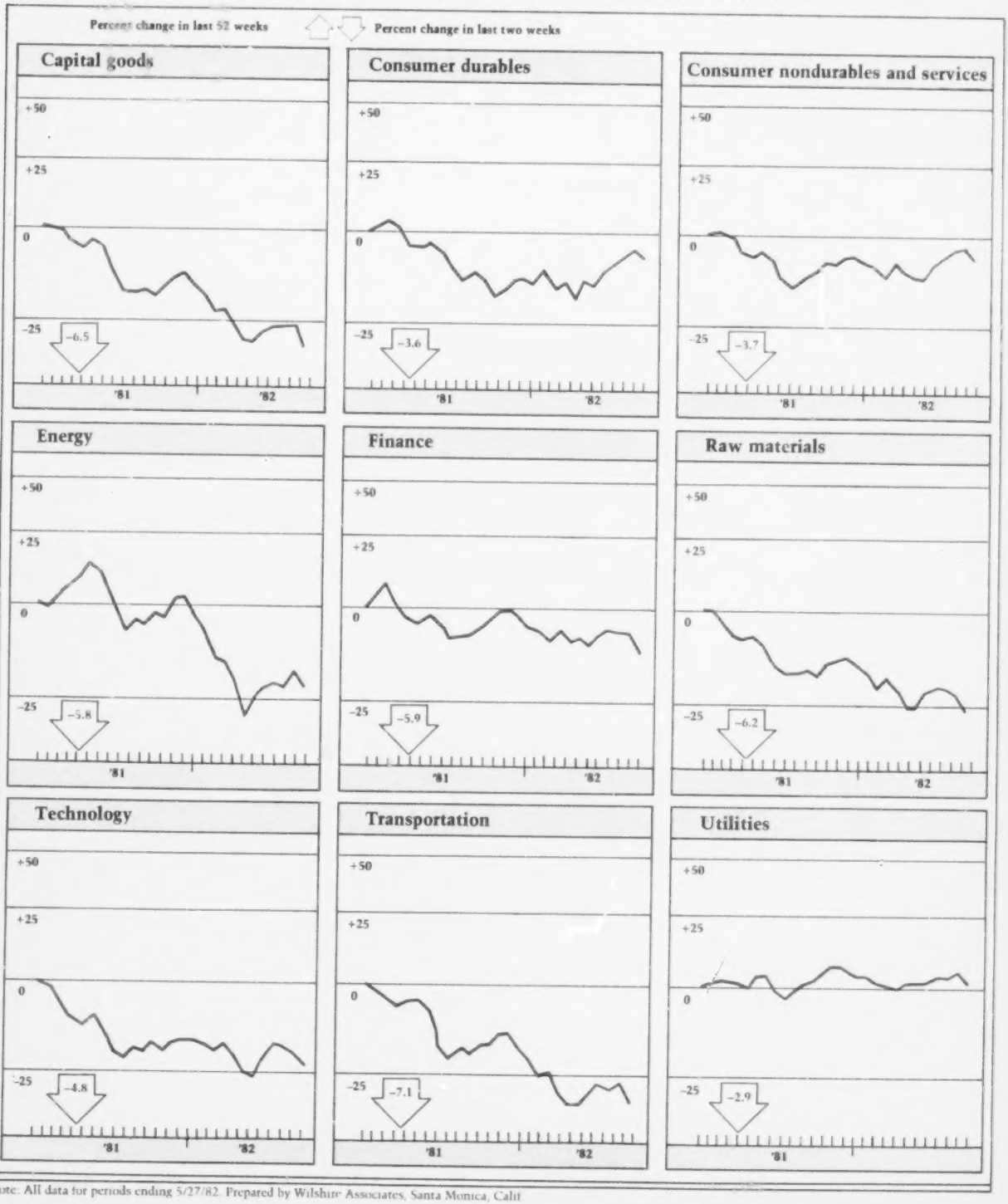
Percent change	Volatility*		P/E multiple		Dividend yield		Growth profile†		Share price	
	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	–3.7	–0.9	–2.4	–0.9	–1.8	–2.6	–2.3	–1.7	–4.1	–1.6
in last 52 weeks	–18.2	4.4	–27.7	–4.7	2.2	–11.2	–15.5	–3.0	–16.7	–11.8

*A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations; low-volatility issues are more stable.
†A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 5/27/82. Prepared by Wilshire Associates, Santa Monica, Calif.

Nobody is spared. During the last two weeks the market declined 4.9%. Transportation issues were leaders in the rout, plunging 7.1%. Capital goods and raw materials also had substantial losses, 6.5% and 6.2% respectively. Energy and finance issues, meanwhile, had declines of almost 6%. This time even utilities were unable to buck the market. They were off 2.9%.

The four-week picture is almost as bleak—except that consumer durables and energy stocks had comparatively strong performances at the beginning of the period. Over four weeks, the energy sector is ahead 1%, while all other sectors are behind. This is in sharp contrast to the last 18 months, in which oil-related issues were at the forefront of a bear market. The recent strength of energy stocks also explains, in part, the relatively strong performance of the Amex over the last four weeks.



Note: All data for periods ending 5/27/82. Prepared by Wilshire Associates, Santa Monica, Calif.

These days plain old profit gains are hard to find. So how about a list of companies whose earnings growth is accelerating?

A tough test to pass

By Steve Kichen

SHOPPING FOR COMPANIES with high rates of earnings growth is old hat to most investors. This time, however, we are using some powerful computer analysis to push the concept to its outer limits.

For starters, we took a standard list of publicly traded companies that have managed to post average profit increases of 15% or better over the past five years. That's an elite enough group, but then we added a few more hurdles. We culled the winners to include only those companies that have accelerated their gains over the past few troubled quarters. What's more, we also demanded above-average five-year and one-year returns on equity and high marks on several measures of relative price performance.

William O'Neil, a pioneer in the art of using computers for securities research, helped us develop the criteria for scanning a broad list of stocks. Back in 1958, O'Neil started his career as a broker, and within five years he had his own seat on the NYSE. But rather than confining his attention to the sales side of the securities business, O'Neil developed a strong interest in collecting, analyzing and interpreting market data.

Over the last two decades William O'Neil & Co., his Los Angeles-based institutional research firm, has built up a data base of more than 7,000 publicly traded securities in 200 different industries. O'Neil draws on this storehouse to develop several statistical products. Large institutional clients are the mainstay of O'Neil's business, and they can buy fat weekly stock reports and customized stock screens. In addition, O'Neil has recently launched *Long Term Values*, a weekly market service aimed at individual investors. It keeps tabs on 4,000 securities and costs $195 for a one-year subscription.

For our particular test, we eliminated firms with a market capitalization of less than $50 million and an average daily trading volume of fewer than 1,500 shares. After screening for five-year, 15% annual earnings growth, we made another cut: Out went companies that haven't managed year-to-year earnings gains of at least 12% for the most recent four quarters.

Stocks that survived these screens then went for the really high hurdles. Earnings for the most recent quarter had to be at least 8% higher than earnings for the same quarter 12 months ago. If that figure seems relatively low, it is—a concession to the fact that even the best businesses are not totally immune to an economic slowdown. Earnings for the next-to-most-recent quarter had to meet a tougher standard. They had to go up at least 20% from the same period one year ago.

Since we wanted to be really selective, we also asked the computers to drop any firm that didn't show at least a 12% return on equity for the last 12 months and a five-year average return on equity of 14% or better. There was one final gauntlet to run: Each company had to pass several "relative strength" screens. These compare the price appreciation of its shares to that of the S&P's 500 over an equivalent period.

O'Neil prefers stocks that are strong relative to the market and particularly likes securities whose relative strength was higher during the last bottom of the market than it was at the previous peak. His logic: If a stock can be strong when the market is slipping, it is likely to do well when the market picks up.

William O'Neil, pioneer in computerized securities research
"In this environment, growth is more important than bargains."

Statistical Spotlight

In order to get on our list, a stock had to have a relative strength of at least 75%, meaning that it had to be among the top 25% in terms of relative price performance.

After all this churning, we ended up with a collection of 27 securities that borders on the bizarre. Our list runs the gamut from Dreyer's Grand Ice Cream to the New York Times Co. Not too surprisingly, there are several high-tech firms and pharmaceutical houses. But a number of retail and food processing companies also made the grade.

Price Co., a West Coast discount chain and NASDAQ newcomer, shows the strongest five-year growth rate of 138%. Healthdyne, a manufacturer of health-care-related electronics, leads the list, according to year-to-year 12-month earning gains. It is up 404% and its earnings in the previous quarter show a 329% jump from a year ago. On the basis of this yardstick, however, First Boston, a securities brokerage firm, leads the pack with a 473% gain. At its present price, First Boston is selling at an earnings multiple of less than 4. It may combine the best of both worlds. But remember, O'Neil likes growth, so a stock isn't attractive to him just because it looks like a bargain.

Since O'Neil is so well plugged into statistics, we also checked his overall assessments of the market. He is no longer as bullish as he was in March 1978. But he does feel that the best stocks have already made their lows. "In this environment I prefer stocks that for the last four, five or six quarters show a strong increase in earnings," O'Neil explains. "A company that has only a 5% or 10% increase might come out with poor numbers next quarter, but if the earnings are up 40% or 50% or so, and it has been sustaining that for the last several quarters, the company is less apt to come in with a bad report."

Right now, O'Neil's favorite companies are those in the consumer sector and small, defense-oriented electronics firms. As for the computer industry, he likes peripheral manufacturers, which he thinks have opportunities to match up their products to all the new computers that have been installed over the last several years.

With his two high-powered computers and a gaggle of bright programmers and analysts, O'Neil has built models of scores of stocks that have been top performers over the last 25 years. Some of his experience went into preparing our list. We aren't guaranteeing these 27 stocks are bound to go up, nor will O'Neil. What we are sure of, however, is that they pass nearly as tough a series of earnings growth criteria as we've been able to concoct. ■

Cream of the crop

From a universe of over 7,000 publicly traded companies, only the 27 corporations below pass through a series of demanding screens. Pay particular attention to the three columns under "% change in earnings." The first, "Latest 12-month" compares earnings in the most recent four quarters with the same period one year ago. "Current quarter" compares the most recent quarter with its counterpart 12 months ago, while "previous quarter" measures earnings one quarter earlier with the equivalent quarter in the prior year.

			—Latest 12-month—		5-year	——% change in earnings——			--Return on equity—	
Ex	Company/business	Recent price	EPS	P/E	EPS annual growth rate	latest 12 month	current quarter	previous quarter	latest fiscal year	5-year average
o	**State Street Boston**/banking	37⅞	$7.08	5.4	65%	20%	28%	70%	12.5%	14%
n	**Anheuser-Busch**/brewing	47¼	5.00	9.5	25	32	55	24	16.7	18
o	**Coca-Cola Btlg Miami**/btlg	42¾	4.60	9.3	23	45	54	25	22.7	20
n	**Applied Magnetics**/comp equip	20¼	1.67	12.1	21	60	80	94	12.2	16
o	**SEI Corp**/computer svs	26¼	1.13	23.2	28	28	29	53	15.9	121
n	**Syntex**/ethical drugs	34¼	3.32	10.3	28	35	50	28	19.7	18
a	**Bolar Pharmaceut**/eth drugs	19⅛	0.69	27.7	40	43	53	31	32.1	36
o	**Electrospace Sys**/electronics	25½	1.24	20.6	52	56	64	94	31.3	32
o	**Federated Investors**/finance	36½	3.70	9.9	125	77	86	152	61.2	57
o	**First Boston**/secur broker	37	9.79	3.8	46	42	113	473	23.3	17
n	**JM Smucker**/food process	38¾	4.91	7.9	17	31	50	34	15.3	14
o	**Bob Evans Farms**/food process	24¼	1.59	15.6	27	13	27	24	21.9	23
o	**Dreyer's Grand**/food process	32	1.25	25.6	79	84	41	146	44.8	39
n	**Baldwin-United**/finance	33⅞	3.98*	8.5	19	59	79	76	24.3	21
o	**Healthdyne**/electronics	27¾	1.16	23.9	74	404	233	329	35.2	27
n	**Omnicare**/health care svs, sup	28⅝	1.93	14.8	72	22	22	24	23.6	NA
o	**Pandick Press**/printing	17⅛	1.59	10.8	47	61	40	43	24.9	20
n	**Diebold**/banking equip	63¾	3.99	16.0	52	68	98	76	15.2	15
a	**New York Times**/news publ	39	4.56	8.6	18	32	54	21	15.9	15
o	**Price Co**/retail	18¼	0.63	29.0	138	54	55	31	43.2	35
n	**Walgreen Co**/drugstores	26½	3.14	8.4	24	14	12	20	16.8	17
o	**Nutri/System**/wgt-loss ctrs	29	2.09	13.9	113	127	108	114	52.0	56
o	**Shop & Go**/retail	7¾	0.93	8.3	33	26	24	46	22.6	23
n	**Kroger Co**/retail	31⅛	4.49	7.0	16	26	17	59	14.1	14
n	**American Stores**/grocery stores	39⅜	5.42	7.3	17	32	84	57	14.2	15
o	**C-Cor Electronics**/electronics	21	0.97	21.7	93	185	190	117	23.2	28
n	**Reeves Brothers**/textiles	68⅛	10.69	6.4	19	47	14	47	14.2	15

a: American Stock Exchange. n: New York Stock Exchange. o: over-the-counter. NA: not available. *Fully diluted.